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SUBJECT: LEBANON: FINANCE MINISTER SEES DROP IN GROWTH AND
CONFIDENCE, DISCUSSES DONOR CONFERENCE AND OBSTACLES TO
ECONOMIC REFORM

Classified By: Ambassador Jeffrey D. Feltman. Reason: Sections 1.4 (b)
) and (d).

SUMMARY

¶1. (C) Finance Minister Azour on October 5 summarized for the Ambassador, econoff, and S/CRS Coordinator his consultations with the IMF, scenarios for economic performance, and plans for economic reform and the Beirut I donor conference. While deeply concerned about a 2-3 percent negative GDP growth, Azour believes that Lebanese inflation and growth rates will be less dire than Fund estimates. He is optimistic that his privatization efforts will survive domestic political infighting, but is nevertheless eager to enlist post's help in rallying Washington and international donor support. Finally, Azour gave us some useful background on GOL problems in compensating landowners for UNIFIL use of their property. End Summary.

IMF ESTIMATES ROUGHLY IN LINE WITH GOL'S

¶2. (C) Finance Minister Azour sees the recent IMF assessment -- the team concluded its weeklong visit today -- as slightly more pessimistic than GOL thinking. He expects that inflation for the year will be slightly lower than the IMF's 5.5 percent estimate, and sees real GDP growth for 2005 at negative 2-3 percent, rather than the IMF's negative 5 percent. After previous conflicts the Lebanese economy has always bounced back quickly, demonstrating remarkable resilience. This time, however, indicators are showing a slower resurgence, indicating that the magnitude of the damage was larger than expected or that there are continued concerns about the chances of an additional, large scale destabilization.

¶3. (C) Both the GOL and IMF recognized the impact of the war on business confidence, but the IMF report did not factor in the additional impact of continuing political infighting, which Azour believes is having a larger impact on the economy now than before the war. Without a quick restoration of confidence, the GOL could experience a vicious cycle, Azour worried, with lower growth and revenues leading to decreased ability to spend on infrastructure and social services, lower job creation, and in turn greater uncertainty. Thanks to mechanisms that Azour put in place, the GOL has six to 12 months to resolve its political infighting and make progress before the Finance Ministry will run out of resources to manage the nation's finances. A continued gradual political

deterioration could affect the private sector and, in turn, economic stability.

PRIVATIZATION IS POSSIBLE

14. (C) Azour hopes he can take advantage of a six-month window of international good will and domestic popular pressure on politicians to address dire economic forecasts and to implement a "new vision for growth" that includes politically sensitive privatization. The plan is essentially an updated version of the year-old economic blueprint blessed in March by the international financial institutions. Privatization is "doable" now, Azour argues, despite some opposition from both the March 14 coalition and Hizballah, because there are such dire economic forecasts. Azour said that last week he obtained Nabih Berri's support to form various parliamentary committees to work toward passage of several needed laws. Other items will be impossible to pass in the current environment, including a planned tax increase.

15. (C) Azour is trying to sell difficult economic reforms on the premise that they are in both the national interest and politicians' personal interest, as a way for politicians to boost their popularity, and indeed as crucial to their legitimacy. No one wants to be seen standing in the way of huge offers of international aid and prospects for annual growth to return to 5 percent or more. He has taken on board the Hizballah and FPM message that the Ministry must factor the socio-economic impact of their rhetoric into decisions. Should there be a cabinet change or new elections, a potential new government would face the same problems, without the majority needed to pass legislation to address those problems. As the extent of the economic damage becomes publicly known, Azour believes, Hizballah's arguments that it

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achieved a victory will be weakened.

BEIRUT I CONFERENCE PLANNING WELL UNDER WAY,
ENGAGING INTERNATIONAL SUPPORT WILL BE KEY

16. (C) Planning for the donor conference is well underway, Azour told us, with a team of 20 from the Finance Ministry and the Economy and Trade Ministries, the Central Bank, the Prime Minister's Office, the Council for Development and Reconstruction, and overseas Lebanese on leave from the international financial institutions who are working full time on updating a pre-existing policy plan and conference documents. Because of the war, donors should now front-load assistance, not dole out aid in tranches, with the understanding that World Bank President Wolfowitz and other major IFI players will play a personal role in making sure that reforms follow. While the GOL has yet to publish a date for the conference, 30 November is the working goal. The Ministry of Finance expects to have a comprehensive draft document within three weeks. Azour is already engaging Siniora and the other ministers to discuss internal coordination; the major obstacle now is assuring solid international support and selling the policy domestically.

17. (C) Azour was unwilling to give the Ambassador and S/CRS TDYer an estimate of how much donor aid the GOL is hoping for. He instead emphasized the GOL's need to identify niche areas of assistance where the money will not be wasted. He stressed the GOL's "bottom up" estimation of its needs. Azour clearly stated his desire for his team of 20 to work with USG officials for the early identification of GOL needs and promised "an iterative process" of additional meetings with S/CRS Coordinator and others.

UNIFIL LAND COMPENSATION BACKGROUND

18. (C) At the close of the meeting, Azour briefed the

Ambassador on why it has taken the GOL so long to repay landowners whose land UNIFIL is using. The GOL has been afraid to set a precedent under which it would be forced to compensate those whose land was used by Syrian troops, and so had tried a mechanism under which it would pay UNIFIL and have UNIFIL pay the landowners. Azour was not clear about whether the GOL has actually issued the payment to the landowners, although the cabinet decision to pay them was taken over a week ago.

COMMENT

¶9. (C) Just after the conclusion of the July-August conflict, Azour told us that he hoped to achieve zero percent growth in GDP -- a considerable drop from the anticipated 6 percent growth (based on January-June figures). Now, while his more pessimistic current assessment that negative growth of 2-3 percent is less than the IMF's estimate of a 5 percent drop in GDP, it is still alarming. By any logical measure, the blame for the economic woes should rest with Hizballah, both for starting the war and for the current frightening political climate that is causing further deterioration in confidence. But, following the rule that incumbent governments suffer and opposition benefit from economic stagnation or decline, we fear that it is the Siniora government and March 14 movement that will be weakened by the economic woes.

¶10. (C) We need to revise all of our own assumptions about what our contribution would be to a Beirut I conference in light of the very real danger that the pro-Syrians will work ever more forcefully to change the Siniora cabinet. Unfortunately, the pro-Syrians' call for a "national unity government" is starting to sound reasonable to many Lebanese, who are frightened by the escalated political rhetoric of Hizballah and Michel Aoun. By hinting that Lebanon is on the verge of civil war, Hizballah and Aoun succeed in convincing people that a national unity government is a better option. But if we can show leadership in assembling a substantial financial package for Beirut I, then -- as Azour says -- the choices look different. Knowing the depth of the economic and financial crisis, most Lebanese would not want to see their country lose such a package. Beirut I can be, in other words, an important lifeline for the Siniora government, if enough financial incentives are assembled.

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